Office-Supreme Court, U.S.
FILED
JUL 24 1981
ALEXANDER L. STEVAS,
CLERK

No. 80-2187

In the Supreme Court of the United States

OCTOBER TERM, 1980

MARGARET E. JOHNSON MALMSTEDT AND
ESTATE OF BERTIL MALMSTEDT, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

LAWRENCE G. WALLACE
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-2187

MARGARET E. JOHNSON MALMSTEDT AND
ESTATE OF BERTIL MALMSTEDT, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioners seek review in this federal income tax case of the denial of net operating loss carry-forward deductions for 1964, 1965 and 1966, resulting from losses allegedly incurred in their taxable years 1960 through 1963. The decision below held petitioners had failed to meet their burden of proving either the amount of their losses in the earlier years or the other conditions for carry-forwards of losses to the years in issue established by Section 172 of the Internal Revenue Code of 1954 (26 U.S.C.).[1]

---

[1]Section 172(a) of the Internal Revenue Code of 1954 (26 U.S.C.) allows "as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year." The term "net operating loss" is defined in Section 172(c) as "the excess of the deductions allowed [for the taxable year] * * * over the gross income" with modifications enumerated in Section 172(d). Where an individual establishes

The pertinent facts may be summarized as follows: Petitioners operated a real estate development business until 1964, when their inability to obtain continued financing for their so-called Gold Mine development resulted in the sale of that property on foreclosure. On audit, the Commissioner of Internal Revenue determined deficiencies in income taxes for 1963-1966, arising from a number of items related principally to their development projects. The Tax Court affirmed the Commissioner's determinations with certain modifications. See *Malmstedt* v. *Commissioner*, 35 T.C.M. (CCH) 199 (1976). In that proceeding, in response to petitioners' claims for deductions for net operating loss carryovers from 1960 through 1963, the Tax Court ruled that petitioners' submission of tax returns for the earlier years was insufficient proof to satisfy petitioners' burden of establishing their right to net operating loss deductions (*id.* at 209). The court of appeals reversed on other issues and remanded the case. *Malmstedt* v. *Commissioner*, 578 F. 2d 520 (4th Cir. 1978). On remand, petitioners repeated their inability to produce evidence, other than their tax returns for the earlier years, in support of their claimed net operating loss deductions. The Tax Court reaffirmed its determination that petitioners had failed to meet their burden of proving entitlement to the deductions (Pet. App. 21a). The court of appeals affirmed (Pet. App. 9a-10a).

---

the existence of a net operating loss, he is authorized to carry such loss to the third year preceding, and the fifth year following, the taxable year of the loss. Section 172(b)(1)(A) and (B). The individual is required, under the provisions of Section 172(b)(2) of the Code, first to carry the loss "to the earliest of the taxable years to which * * * such loss may be carried," the remaining loss then being applied against "the taxable income for each of the prior taxable years to which such loss may be carried." (Section 172(b)(1)(A) and (B) and (b)(2) was amended by Section 203, Small Business Tax Revision Act of 1958, Pub. L. No. 85-866, 72 Stat. 1678).

The decision below correctly held that the burden was on petitioners to establish the existence of all facts upon which their claimed deductions for net operating losses depended. *Stout* v. *Commissioner*, 31 T.C. 1199 (1959), aff'd on this ground, 281 F. 2d 233 (4th Cir. 1960). And see *Welch* v. *Helvering*, 290 U.S. 111 (1933). It is well established that a taxpayer's return is insufficient, without corroborative proof, to establish taxpayer's right to claim deductions, including net operating loss deductions. *Seaboard Commercial Corp.* v. *Commissioner*, 28 T.C. 1034, 1051 (1957); *Jones* v. *Commissioner*, 25 T.C. 1100, 1104 (1956), rev'd on another issue, 259 F. 2d 300 (5th Cir. 1958); *Moore* v. *Commissioner*, 8 B.T.A. 749, 754 (1927); *Ryza* v. *Commissioner*, 36 T.C.M. (CCH) 269 (1977). See, generally, 9 J. Mertens, *Law of Federal Income Taxation* § 50.61, at 159 (1977 rev. ed.). The propriety of such a rule is readily apparent in this case where, as both lower courts recognized (Pet. App. 9a, 20a; and see 35 T.C.M. at 204, n.13, and 206-207), the returns for several of those years were demonstrably erroneous.[2] There is no support for their contention that the mere fact that the Internal Revenue Service has failed to audit a return confers a stamp of approval on all facts asserted in that return.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

LAWRENCE G. WALLACE
Acting Solicitor General

JULY 1981

---

[2]The unreliability of petitioners' returns was demonstrated by the fact that they erroneously reported a sale on their 1962 partnership return which never took place (see 35 T.C.M. at 206-207) and reported as income in 1963 $152,524.75 which was in fact a loan repayment (see 35 T.C.M. at 204, n.13).